Reshoring 101: Right-Sizing U.S. Manufacturing, Part 2

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This is part two of a two-part piece. Part one can be found here. *[1]*

The Consequences of Offshoring

The companies that sent their manufacturing to foreign countries soon discovered there were frustrations and costs they never anticipated. They found that differences in language made communicating product specifications and manufacturing instructions to their offshored sources difficult. They learned that cultural differences made it difficult to motivate the foreign companies to respond quickly to their needs.

Graft — or payment under the table — was often necessary to break logjams such as finding lost parts, getting a higher priority in a production schedule, or releasing shipments. Conference calls to deal with these issues would have to be scheduled across different time zones, further frustrating the offshoring company.

When issues could not be solved over the phone, visits abroad became necessary, incurring more costs and tying up valuable human resources. Some companies decided to make periodic overseas visits to keep things under control or to put a full-time company representative on site. The costs were just beginning to expose themselves. When production or quality assurance steps were not followed, products could end up at the parent company requiring rework. Being compensated for the reworking of defective products was unlikely.

The list of offshoring problems and resulting costs continued. Purchasing offshored goods usually began with a prepayment. Order quantities were not what was needed, but rather based on what a shipping container would hold. Add a production lead-time of four weeks and a shipping time of another four weeks — all in addition to the massive order quantities — and the result was products, which would not sell for many more weeks, that required storage and inventorying. There was a constant threat of obsolescence and spoilage.

Cash flow slowed to a snail’s pace, especially with 30-day net terms to customers. Costs escalated and profits shrunk. But there’s more! Offshored countries are notorious for pirating the intellectual property U.S. companies give them to make their products. Suing the foreign source typically is ineffective because of weak or nonexistent judicial support in the foreign country.

Offshoring has consequences for the U.S. as well. The flight of manufacturing jobs offshore has meant record unemployment, reduced gross national product and a dwindling tax base, with less than half of Americans paying federal income taxes. In some cases, whole towns have struggled because of offshoring, such as Hershey, PA, where all Hershey chocolate used to be made.

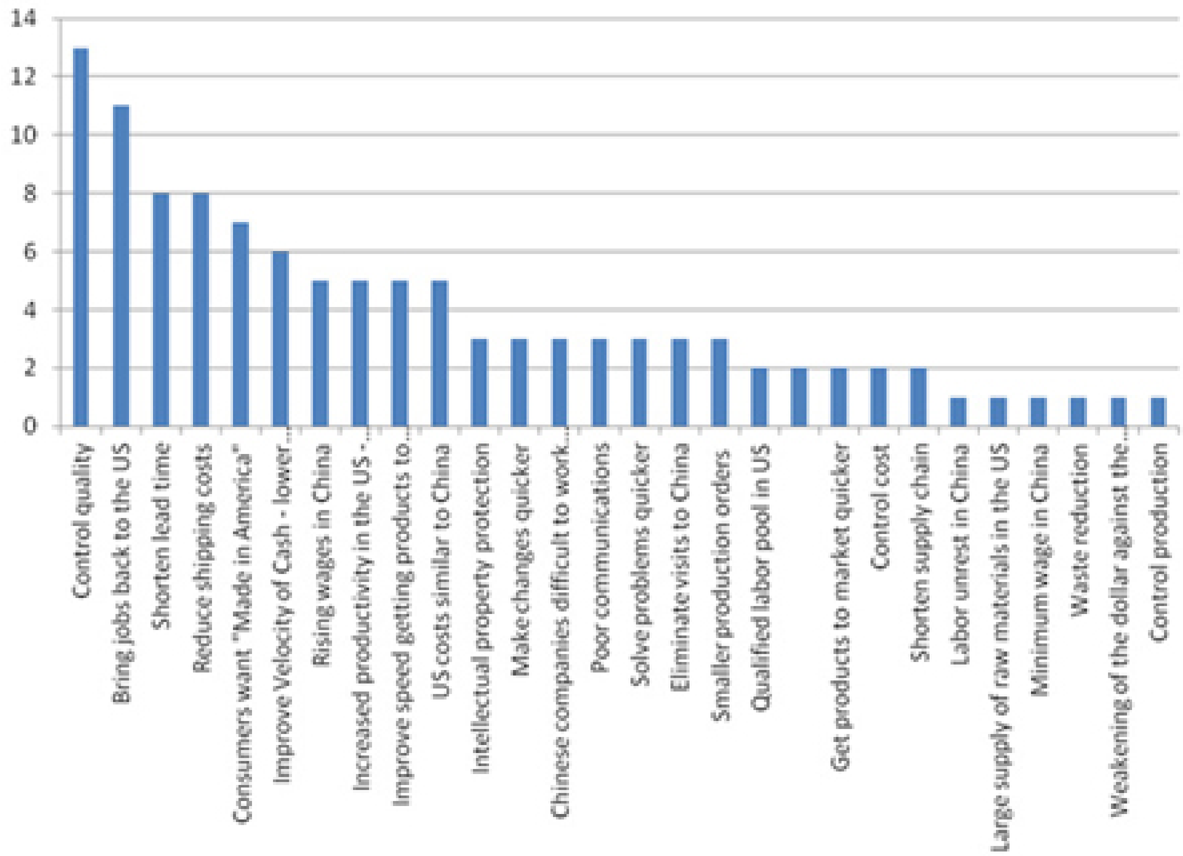
Locally-owned “mom and pop” stores have disappeared because their customer base has moved on, or is standing in the unemployment line. Skilled trades have become extinct because their demand has moved to foreign countries. Toolmaking, machine operating, machining and welding have been especially hard hit. Youth have little or no interest in manufacturing, as all their role models (parents, uncles, aunts and neighbors) who used to work in the factories no longer do so. The demand for manufacturing jobs is almost nonexistent.

The True Cost of Offshoring

These issues add up to the true cost of offshoring, which is known as the total cost of ownership (TCO). For the consumer, the TCO includes how often the product does not work properly, and must be taken back to the store, or repurchased. For the U.S. company, the TCO due to offshoring includes the multitude of issues necessary to do business thousands of miles away with people of immeasurable differences in motives, language and culture. For the U.S., the TCO is the loss of a way of life, economic risks and prestige in the world.

Perhaps the best way for businesses to think about the TCO, or the True Cost of Offshoring, is the speed at which their cash moves out of their accounts to pay for everything it takes to bring the product to market, sell the product, and take cash in through invoiced payments. We call this the Velocity of Cash.

Consider the huge outlay of cash that businesses must pay up front to manufacture products made in China — and in order quantities that will take months to sell and that must travel thousands of miles to reach the U.S. In the case of a “Made in China” offshoring scenario, the Velocity of Cash moves at a snail’s pace. Made in America products can have light speed Velocity of Cash, especially when Lean techniques are applied.



Rethinking Offshore Manufacturing

The pace of reshoring operations has accelerated in recent months with more companies analyzing, deciding and moving selected manufacturing process back to the U.S. While the “Made in America” desire for U.S. produced goods may have gotten the ball rolling for reshoring, the Chinese economy has now created an economic advantage for U.S. manufacturers to produce goods stateside.

There are many indicators, particularly in China, predicting the return of U.S. jobs through reshoring:

1. China’s economic boom has its workers demanding higher wages, and even a minimum wage is in the works.
2. The Chinese government is relaxing its support and subsidies to Chinese factories making foreign goods — more production is being saved for Chinese consumers.
3. The Chinese government is allowing its currency to find its value in the world, which will make the yuan more expensive compared to the U.S. dollar.
4. Shipping costs are escalating as the price of oil increases.
5. In the U.S., consumers are becoming disillusioned with the “Made in China” label. U.S. companies are beginning to understand their total cost of ownership for offshoring, and are taking steps to bring their work home, reshoring jobs to America and rebranding their products with “Made in

America."

Businesses that do not recognize the liabilities of offshoring may be left in the dust of those acting now to reshore. Reshoring, like establishing world peace, is easier said than done. Therefore, a carefully thought-out plan that is based on a true understanding of the total cost of ownership is essential for project success.

What's your take? Please feel free to comment below! This is part two of a two-part piece. Part one can be found here. *[1] For more information, please visit* www.mainstreammanagement.com *[2] and/or* www.hamiltoncaster.com *[3].*

Links:
[1] http://www.chem.info/Community/Blogs/CHEM-Blog/Plant-Operations-Reshoring-101-Right-Sizing-US-Manufacturing-Part-1/
[2] http://www.mainstreammanagement.com/
[3] http://www.hamiltoncaster.com/